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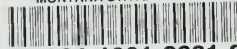


GOVERNORS COUNCIL ON ECONOMIC DEVELOPMENT

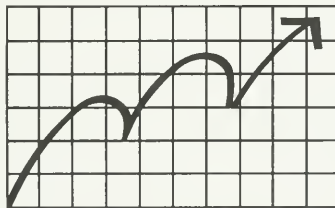
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GOVERNOR'S COUNCIL ON ECONOMIC DEVELOPMENT
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DEPARTMENT OF COMMERCE



TED SCHWINDEN, GOVERNOR

1424 9TH AVENUE

STATE OF MONTANA

(406) 444-3494

HELENA, MONTANA 59620-0401

November 14, 1986

The Honorable Ted Schwinden
Governor of Montana
State Capitol
Helena, MT 59620

Dear Governor Schwinden:

On behalf of the Governor's Council on Economic Development, I am pleased to present to you this second Report of Recommendations. Since December 1985 when the council received its charge from you, we have worked hard to address economic concerns relating to three specific problem areas in the Montana economy. By forming subcommittees to focus our attention on agricultural debt, business climate and the crisis in liability insurance the council has developed a strong package of recommendations, which if enacted, should produce very positive results.

It has been both a pleasure and a privilege for me to serve as chairman of the council. Working with this dedicated group of people is not only rewarding, but encourages me that our economic future will be brighter because of the involvement of these citizens. I am also grateful to all the Montanans who took time away from their businesses and their jobs to make their views known to the council. Their input was an essential part of the recommendation process. Finally, I want to thank the staff for their commitment.

This past year has been most rewarding, and on behalf of the Governor's Council on Economic Development, I thank you for the privilege of serving Montana.

Sincerely,

A handwritten signature in dark ink, appearing to read "W.E. Schreiber".

W.E. Schreiber, Chairman
Governor's Council on Economic Development

ACKNOWLEDGEMENTS

GOVERNOR'S COUNCIL ON ECONOMIC DEVELOPMENT

W.E. "Buster" Schreiber, Chairman

Richard N. Barrett
(Organized Labor)
Missoula, MT

Kim Hansen
(Agriculture)
Harlem, MT

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(Small Business)
Great Falls, MT

Bob Koprivica, Sr.
(Public Interest)
Butte, MT

Diane Brandt
(Small Business)
Glasgow, MT

Margaret E. MacDonald
(Conservationist)
Billings, MT

Jennifer Cote
(Conservationist)
Missoula, MT

J.H. Martinz
(Small Business)
Helena, MT

Carol Daly, Vice Chairman *
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Kalispell, MT

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(Tourism)
Billings, MT

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(Organized Labor)
Billings, MT

Lorrie Merrill
(Agriculture)
Big Sandy, MT

Alan Elliott
(Tourism)
Billings, MT

C. Joseph Presley
(Natural Resource Extraction)
Billings, MT

Mike Fitzgerald*
(Professional Economic Dev.)
Helena, MT

Lewis S. Robinson, III
(Professional Economic Dev.)
West Yellowstone, MT

Kay Foster
(Public Interest)
Billings, MT

Royce Satterlee
(Natural Resource Extraction)
Whitefish, MT

Mike Grove
(Financial)
White Sulphur Springs, MT

William J. Tietz, Jr.
(Education)
Bozeman, MT

* Resigned during appointed term.

SUBCOMMITTEE PARTICIPATION

Insurance Subcommittee

Kay Foster, Chairwoman
Al Bell
Jerry Driscoll
Bob Koprivica, Sr.
Jack Martinz
Jean Mercer
C. Joseph Presley

Business Climate Subcommittee

Carol Daly, Chairwoman (Through August 1986)
Richard N. Barrett, Chairman (After August 1986)
Diane Brandt
Alan Elliott
Mike Fitzgerald
Lewis S. Robinson, III
Royce Satterlee

Agricultural Debt Subcommittee

Mike Grove, Chairman
Jennifer Cote
Kim Hansen
Margaret MacDonald
Lorrie Merrill
William J. Tietz, Jr.

GOVERNOR'S COUNCIL ON ECONOMIC DEVELOPMENT STAFF

Steve Huntington, Administrator
Office of Economic Analysis
Montana Department of Commerce

Phil Brooks, State Economist
Office of Economic Analysis
Montana Department of Commerce

Dwayne Ward, Economist
Office of Economic Analysis
Montana Department of Commerce

Ralph Yaeger, Admin. Officer
Office of Economic Analysis
Montana Department of Commerce

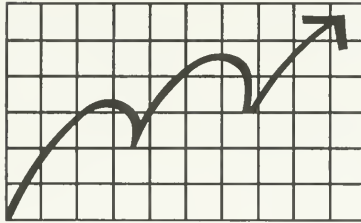
Rici Thomas, Admin. Assistant
Office of Economic Analysis
Montana Department of Commerce

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SECTION I

INTRODUCTION



Background:

The Governor's Council on Economic Development was created by Governor Ted Schwinden on December 12, 1983, in accordance with House Bill 1, which was passed by the 48th Montana Legislature. In granting the governor the authority to form a council of economic advisors, the Legislature specified that a broad cross section of Montana be represented. House Bill 1 states:

It is the intent of the legislature that the Governor's Council on Economic Development be created according to the provisions of Section 2-15-122, MCA, and that the council shall contain representatives from the following sectors of the economy: natural resources extraction and processing industries, small business, tourism, agriculture, education, conservationists, public interest, financial, professional economic development, and organized labor. With regard to representatives of small business, particular emphasis shall be given to small manufacturing enterprises, businesses established around the general preferences listed below, and businesses with nontraditional ownership individuals, in particular women, low-income, and minorities. The council shall be broadly represented with no more than two representatives from each of the ten sectors identified above, except that the small business sector shall be allocated four representatives. No more than ten members may be residents of the same congressional district.

The responsibilities and duties of the council were detailed by the governor in his Executive Order Creating The Council On Economic Development. These duties and responsibilities include sponsoring appropriate economic research, preparing a biennial economic con-

ditions report, developing recommendations for the governor and the Legislature, and acting in an ongoing advisory capacity to the Governor's Office.

Activities in the 1985 Biennium:

During the 49th Legislative Session the council actively supported the recommendations it had developed during 1984. By focusing on five economic areas, the council formulated over 30 recommendations addressing business taxation issues, tourism, agriculture, natural resources, state business assistance programs and transportation.

In December 1985, the full council met with Governor Schwinden to decide which issues most deserved the council's attention during its second session of deliberations. The governor suggested that the council direct its attention to three specific problem areas—business climate, agricultural debt and the crisis in liability insurance.

In order to address these issues in depth, three subcommittees were established within the council. Subcommittee participants were appointed by the chairman, with consideration given to their expertise and interest in a particular area.

The subcommittees were active throughout 1986. To gather information, each subcommittee held at least five public hearings. These hearings were well attended and the public information played a critical role in the subsequent recommendation development. A considerable amount of information was also provided by the Department of Commerce staff and from other state agencies including the Department of Agriculture, the Department of Administration, the Department of Revenue and the Department of Labor and Industry.

Throughout the first half of 1986, the subcommittees studied their respective issues and formed recommendations that were presented to the full council in July. The council's final actions on the recommendations took place in October.

Additional Activities

In July 1986, the council received the final results of a Beef Marketing Study co-sponsored by the council, the Montana Department of Agriculture, the Montana Wheat Research and Marketing Committee and the Montana Stockgrower's Association. The study reveals a potential in Montana for the operation of small- to medium-sized beef packing facilities.

Another action of the council saw it opposing Constitutional Initiative 27, the measure to abolish property taxes in Montana, shortly before the November general election. The council believed passage of such a measure would have a devastating impact on economic development efforts in Montana.

In October the council also passed a resolution which suggests that the governor and the Legislature review,

before the upcoming legislative session, the council's 1984 Report of Recommendations. The council feels that many of these recommendations are still timely and were not addressed by the 1985 Legislature. In particular, the council's recommendation calling for ten-year development strategies for the state's natural resource-based industries deserves attention. The council believes this recommendation can be implemented at a minimal cost by allowing the Department of Commerce to hold a series of meetings with representatives from each of the state's major economic sectors to discuss problems that discourage future development. These meetings would be mutually beneficial to both state government and the industries: state government would become familiar with difficulties that face each industry, and industry would learn what forms of assistance are available from the state.

SECTION II

SUMMARY OF RECOMMENDATIONS



Insurance Recommendations

PROVIDE SPECIFIC DEFINITIONS OF BAD FAITH

Calls upon the Legislature to review the Montana codes and develop clear and concise definitions of bad faith as it relates to insurance claims, banking, and wrongful discharge.

CHANGE MONTANA'S PUNITIVE DAMAGE LAWS

Calls upon the Legislature to cap punitive damages at \$5 million, amend the Montana codes so that judges, not juries, determine the amount of an award, and create a government fund into which 90 percent of all punitive awards will be paid.

LIMIT CONTINGENT FEES

Calls upon the Legislature to cap attorneys' contingent fees at 40 percent.

STRICTER ENFORCEMENT OF RULE 11 OF THE MONTANA RULES OF CIVIL PROCEDURE

Calls upon the courts to more vigorously enforce this rule that serves as a deterrent to the filing of frivolous lawsuits.

GRANT COURTS THE AUTHORITY TO MANDATE STRUCTURED DAMAGE AWARDS

Calls upon the Legislature to grant the courts the authority to mandate structured damage awards, if such an award is in the best interest of either the plaintiff or the defendant.

ALTER MONTANA'S DOCTRINE OF JOINT AND SEVERAL LIABILITY

Calls upon the Legislature to change Montana's doctrine of joint and several liability so that defendants would be responsible only to the degree that they are found to be negligent.

MODIFY THE COLLATERAL SOURCE RULE

Calls upon the Legislature to change Montana's collateral source rule so that the courts can make informed decisions regarding the compensation of plaintiffs.

Business Climate Recommendations

ALLOW LOCAL OPTION TAXATION

Calls upon the Legislature to pass a law allowing local sales and/or income taxes with local voter approval.

LOWER MONTANA'S CORPORATE INCOME TAX

Calls upon the Legislature to eliminate special business tax measures so that the added revenue can reduce the corporate tax rate from 6.75 to 4.75 percent.

BROADEN BASE AND REDUCE RATE OF MONTANA'S INDIVIDUAL INCOME TAX

Calls upon the Legislature to incorporate federal personal income tax reform provisions to broaden Montana's base and reduce individual income tax rates overall.

REVISE THE UNITARY METHOD OF CORPORATE INCOME TAXATION

Calls upon the Legislature to enact changes in the state's law to reflect the current practice of excluding foreign parent corporations from unitary income tax computations.

REVIEW THE PERSONAL PROPERTY TAX

Calls upon the Legislature to perform a thorough review of the Montana personal property tax.

REVIEW MONTANA'S TAX STRUCTURE

Calls upon the Legislature to review the state's tax structure with a view toward property tax reform.

REDUCE MONTANA'S COAL SEVERANCE TAX

Urges the governor to recommend to the Legislature that Montana's 30 percent coal severance tax be reduced to make the state more competitive with other regional producers.

Agricultural Debt Recommendations

RE-ESTABLISH THE LINKED DEPOSIT FARM LOAN PROGRAM

Calls upon the Legislature to support the continuation of a revised linked deposit farm loan program.

ALLOW EMERGENCY STATE CHARTERING

Calls for legislation to allow immediate chartering of a new state regulated bank in a failed bank situation.

PROVIDE FOR EMERGENCY BRANCH BANKING

Calls for legislation to allow emergency branch banking in cases where a bank failure represents the loss of a community's only bank.

ESTABLISH AN AGRICULTURAL NETWORK

Calls upon the governor to implement an informational agricultural network in Montana.

ADDRESS FARM AND RANCH INCOMES

Calls upon the Montana Department of Agriculture to implement a program to raise the level of awareness of farmers and ranchers with regard to innovative income sources.

SUPPORT AGRICULTURE COUNSELING AND MEDIATION PROGRAM

Calls upon the Legislature to fund and support the counseling and mediation programs at the levels outlined in the Department of Agriculture's 1989 biennium budget request.

ESTABLISH A BEEF INSPECTION AND GRADING PROGRAM

Calls for legislation to establish a state-run inspection and grading program that would encourage the production of value-added beef products in Montana.

RESTORE AND INCREASE FUNDING FOR THE MONTANA AGRICULTURAL EXPERIMENT STATION SYSTEM

Calls upon the Legislature to restore the original FY87 appropriations level, plus an additional \$500,000 per annum for capital improvements.



SECTION III

INSURANCE RECOMMENDATIONS



Provide Specific Definitions of Bad Faith

Recommendation: The council recommends that the Legislature address the issue of bad faith as it pertains to insurance claims, wrongful discharge and the lending policies of financial institutions. In each of these areas, problems exist that dramatically increase the cost and risk of doing business, and affect the affordability and availability of insurance. The Legislature should review sections of the Montana Code Annotated that address bad faith and work to develop clear and concise definitions to eliminate the ambiguities that currently exist.

Rationale: Montana's Unfair Trade Practices Act, Section 33-18-201, MCA, Insurer's Relations With Insured, contains 14 subsections listing claims settlement practices that constitute bad faith on the part of an insurer. Within the 14 subsections, considerable latitude exists for juries to decide if bad faith actions have been committed. Similarly, in the areas of wrongful discharge and the operations of financial institutions, the state's laws allow juries a great deal of flexibility in making bad faith determinations.

Revision of the Montana codes with regard to bad faith is necessary to ensure that a fair and equitable civil justice system exists for all Montanans.

Change Montana's Punitive Damage Laws

Recommendation: The council believes that changes should be made in Montana's laws pertaining to punitive damages. Large damage awards have been cited by one major supplier of liability coverage as the reason it chose to discontinue operations in the state. Other companies single out this issue as an area in which the state could create a more stable operating environment for the industry.

The council recommends that the following measures be enacted by the Legislature.

1. Amend the limits set forth in HB 363 to an amount up to but no greater than \$25,000, or 1 percent of a defendant's net worth with awards not to exceed \$5 million, whichever is greater.

2. Amend the Montana codes so that judges, not juries, determine the amount of an award.
3. Amend the Montana codes so that punitive damages are paid into a government fund, rather than to the plaintiff. The subcommittee suggests that 90 percent of an award be placed in this fund. One use of the fund, which the subcommittee feels should be investigated, is to pay district court costs. The remaining 10 percent of the award would be presented to the plaintiff.

Additionally, the council recommends that in filing a lawsuit, the plaintiff be allowed to specify only the amount of economic damages he or she wishes to recover, not a specific amount of punitive damages. In regard to punitive damages, judges would instruct juries before its deliberations that they are to determine only if the payment of punitive damages is in order, and that upon reaching a verdict, the judge will determine the amount of the award if the jury has decided for the plaintiff.

The council thinks that adoption of these measures will remove much of the uncertainty associated with the punitive damage issue and create a more stable operating environment for both the insurance industry and the business community.

Rationale: Punitive damages are awarded to punish defendants for negligent, wanton or willful actions. They are considered a form of non-economic damages, that is they are awarded not to make the plaintiff whole, but to set an example that such actions by a defendant will not be tolerated.

In 1985, the Montana Legislature passed House Bill 363, which limits the right of a plaintiff to recover punitive damages. HB 363 allows juries to award punitive damages in an amount up to, but not greater than \$25,000 or, 1 percent of the defendant's net worth, whichever is greater.

Since HB 363 was enacted, there has been considerable debate as to whether the bill provided the stability that

was intended. Several groups, including representatives of the business community and the insurance industry, argue that 1 percent of a defendant's net worth, especially in the case of a multi-million dollar corporation, can be a huge sum of money. They would like to see a specific dollar limitation on the amount that can be awarded. On the other hand, the Montana Trial Lawyers Association contends that since HB 363 has been on the books for such a short period of time, it is too soon to make any changes or amendments.

Another area of contention in this issue is whether juries should be allowed to award punitive damages. There are those who hold that it is impossible to achieve any degree of stability in this area when awards can vary greatly depending on the jury. They feel that juries should be allowed to determine if the payment of punitive damages is in order, but that judges, because they have more experience and are able to compare similar cases, should determine the amount of the award.

A final argument is one concerning who should be the recipient of a punitive damage award. Here, the insurance industry has contended that awarding the entire settlement to the plaintiff has encouraged plaintiffs to seek outrageous sums. The industry argues that in criminal law, fines are paid to the government, and that similarly, punitive damages should also be paid to the government, because they are essentially fines that are paid in civil actions.

Limit Contingent Fees

Recommendation: The council believes that contingent fee arrangements between an attorney and a client should be left unregulated for the most part. However, the council also feels that in all cases the client should receive the largest portion of the settlement. It, therefore, recommends that contingent fees be capped at 40 percent.

Rationale: Contingent fees are charged by lawyers and are based on a percentage of the final award rather than an hourly rate. Nationally, consumer groups and lawyers contend that contingent fees allow access to the courts and the opportunity to seek a remedy to a wrongful action by people who otherwise cannot afford to file suit.

While contingent fees broaden the public's ability to sue, it has also been argued that they encourage lawyers to seek larger than normal settlements.

Many states have adopted limitations on contingent fees, often basing them on a sliding scale where the percentage of the fee decreases as the size of the award increases.

Stricter Enforcement of Rule 11 of the Montana Rules of Civil Procedure

Recommendation: The Governor's Council on Economic Development believes that attorneys have a responsibility to inform potential clients whether their complaints are well-grounded in fact and law. The council recommends that Rule 11 of the Montana Rules of Civil Procedure be enforced so that when a party files a lawsuit, the party's attorney must sign every pleading, motion or other paper that is presented to the court. Consequently, anytime an attorney, with a client, is involved in a lawsuit, the attorney must take responsibility that the complaint is reasonably grounded in fact and law.

If the court deems that the suit is frivolous, it must impose an appropriate sanction, which may include an order that the attorney pay the other attorney's fees and expenses incurred because of the filing of the frivolous paper.

Rationale: A major problem cited in the nationwide liability insurance crisis is the rising number of frivolous lawsuits. In Montana, a statute exists that should serve as a deterrent to frivolous lawsuits. However, it is rarely used.

Rule 11 of the Montana Rules of Civil Procedure requires that every pleading, motion or other paper filed in court must be signed by the party or their attorney. The signature certifies that to the best of the signer's knowledge, formed after a reasonable inquiry, it is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification or reversal of an existing law.

If the complaint is not grounded in fact and law, the court, either by its own motion or by motion of the affected party, must impose an appropriate sanction, which may include an order to pay the other parties the amount of reasonable attorney's fees and expenses because of the filing of frivolous paper.

Grant Courts the Authority to Mandate Structured Damage Awards

Recommendation: The council recommends that if the court finds that a structured damage award is in the best interest of the plaintiff or the defendant, the court would have the authority to mandate structured awards for future economic losses. The structured award must be adjustable and take into account inflation and the time value of money. The council feels that structured awards are not necessary in all cases, and recommends that only awards in excess of \$100,000 be subject to the court's mandate.

Rationale: Large lump sum damage awards can create problems for both plaintiffs and defendants. These problems include financing difficulties for the defendant and difficulties associated with managing a large sum of money for the plaintiff. Studies in workers' compensation cases nationwide have indicated that money received in awards is not always wisely invested, and that in many cases, money that was awarded in a lump sum to sustain an injured party for a lifetime is spent or lost in a period of several years.

Structured settlements are less expensive for defendants to finance and guarantee the plaintiff long-term financial security.

Alter Montana's Doctrine of Joint and Several Liability

Recommendation: In order to create an environment that will encourage insurance companies to provide liability coverage to governmental entities, businesses and individuals, the Governor's Council on Economic Development recommends that Montana's doctrine of joint and several liability be changed so that defendants are responsible only to the degree that they are found to be negligent.

Rationale: The doctrine of joint and several liability is based on the concept that when the negligence of two or more individuals results in injury to a person, those individuals are jointly and individually liable for damages. The doctrine permits the plaintiff to recover the entire amount of a judgment from one defendant, forcing that individual to recover from the other defendants. The degree of negligence of the defendants is not a consideration because the defendant who is 1 percent negligent may be required to pay the entire judgment.

In Montana, the doctrine of joint and several liability has made it particularly difficult for local government entities to obtain liability coverage because they are often seen as having unlimited resources to pay judgments, and are therefore the targets of lawsuits even though their negligence is minimal. According to the Montana League of Cities and Towns, at least 65 local governments have had their liability coverage cancelled or have experienced such a dramatic rate increase that they were forced to continue operations without insurance.

Modify the Collateral Source Rule

Recommendation: The council recommends that the collateral source rule in Montana be modified so that the courts must receive evidence of the amount of collateral source payments. All sources of compensation, excepting state and federal programs that are required by law to seek subrogation, shall be admissible as evidence. This change will allow judges to make informed decisions regarding the reimbursement of providers of prior and future compensation.

The council does not wish to limit a plaintiff's right to be compensated from more than a single source, nor does it feel that defendants should benefit because a plaintiff maintained insurance at his own expense. In addition, while the council wishes to ensure that plaintiffs will continue to be fairly compensated for losses and injuries, it is concerned that recovering a full amount of injuries from each of several sources does indeed cause insurance premiums to escalate.

Rationale: Under the collateral source rule, benefits received by a plaintiff from a source wholly independent of and collateral to the defendant will not diminish the damages otherwise recoverable from the defendant. The rule guarantees that wrongdoers will be responsible for their actions and not benefit from the fact that a plaintiff has maintained his own insurance.

As an example, suppose a person who maintains their own medical and accident insurance were injured by a negligent driver. The victim's medical bills would be covered by his own insurance and depending on the accident insurance, the victim would receive a sum for the time he was incapacitated. Simply because the person maintained his own insurance, he is not barred from filing suit against the negligent driver and recovering for medical bills and other expenses due to the injury. The collateral source rule allows the victim to seek compensation from additional sources without disclosing any amount he has already received.

In Montana, the collateral source rule has not been adopted by statute. However, the rule has been recognized and adopted by the Montana Supreme Court. It has been argued that the rule drives up the cost of insurance because it can lead to dual recovery for the same injury or property damage. For this reason, the rule has been modified or abolished in at least 15 states.



SECTION IV

BUSINESS CLIMATE RECOMMENDATIONS



Allow Local Option Taxation

Recommendation: The Governor's Council on Economic Development recommends that legislation be enacted to allow Montana local governments, upon the approval of local voters, to levy local sales and/or income taxes.

Rationale: Many Montana local governments face the problems of keeping existing infrastructure up to standard while meeting other urgent needs. While communities are required to maintain a broad range of services and facilities, they are often unable to raise necessary funds through present sources.

Implementation of this recommendation would allow local governments to tailor their tax policies to specific needs, including the offset or replacement of a portion of their respective property tax mill levies.

Lower Montana's Corporate Income Tax

Recommendation: The council recommends that corporate income tax legislation be enacted to broaden the tax base by eliminating various special credits, deductions and accounting procedures. The resulting revenue would be used to cut the corporate tax rate from 6.75 percent to 4.75 percent.

Rationale: Broadening the tax base is desirable for several reasons. First, it eliminates tax benefits that promote inefficiency and misuse of Montana's resources. Because tax benefits are more available to some businesses than to others, these benefits encourage the flow of capital and other resources to favored businesses whether or not those businesses are truly the most productive. In addition, tax benefits may promote the inefficient use of resources within firms, such as the premature replacement of physical assets and the diversion of accounting and managerial resources to the preparation, review and defense of tax returns. At the state level, tax benefits increase the complexity and cost of administration.

Second, base broadening serves the general goal of promoting a fair and evenhanded tax policy. Although studies specific to Montana are not available, studies of the federal corporate profits tax indicate that different firms and industries, after taking what advantage they can of existing tax benefits, pay dramatically different effective tax rates. Because many federal tax advantages exist in Montana law as well, it is likely that similar results would pertain to the state. Such differences are inequitable as well as inefficient.

Finally, base broadening may serve to promote economic growth through its impact on the business climate. On the one hand, of course, it eliminates tax benefits that are valuable to some businesses and which may encourage them to invest in Montana. On the other hand, base broadening permits a decline in the general tax rate, which in turn permits Montana to represent itself as a state with low corporate taxes available to all investors regardless of industry, firm size, or whether the business is a newcomer or already established in the state.

Broaden Base and Reduce Rate of Montana's Individual Income Tax

Recommendation: The Governor's Council on Economic Development recommends incorporating federal personal income tax reform provisions into Montana law, and reviewing state law to identify further opportunities for base broadening and general rate reduction.

Rationale: The council's recommendation is based on the following considerations.

First, prior to federal reform, similarly situated Montana taxpayers tended to be subject to quite different effective tax rates. This, of course, was because some taxpayers had greater opportunity than others to take advantage of various exemptions, deductions, and other provisions contained in both federal and state tax law.

In general, these tax advantages are of little value to lower income taxpayers and therefore have relatively little impact on the effective tax rates they pay. Taxpayers with higher incomes have much more incentive to take advantage of these provisions, where possible, and wide disparity in effective rates was particularly acute at higher income levels.

When taxpayers with equal incomes pay different taxes, there are two undesirable consequences. First, the basic principle of horizontal equity (equal treatment of taxpayers within a particular range of income) is violated. Second, the neutrality of the tax system, which requires that it not favor one sort of economic activity or individual at the expense of another, is diminished.

The council believes that tax neutrality promotes economic development. This is because it guarantees to all types of new economic activity the same opportunity to succeed, at least insofar as tax burdens are concerned. The council believes that in an economy in transition, as Montana's is, it is difficult to know with confidence which activities are most likely to prosper and lead to further economic expansion. In such a situation, therefore, wise policy is as neutral as possible and permits the market to take its course.

The second consideration in the council's recommendation is that prior to federal tax reform, the apparent progressivity of the Montana income tax was, to a significant degree, spurious. In 1985, for example, as household income rose from very low levels up to about \$40,000, effective tax rates rose from zero to about 5 percent. Above that income level, however, effective rates actually tended to decline, despite the fact that the maximum marginal tax rate was 11 percent. Because of tax advantages, this rate, which is quite high by national standards, was applied to only a fraction of high incomes. Thus, tax advantages had the effect of placing a disproportionate share of the tax burden on the middle income taxpayers to the benefit of high income ones, while at the same time eroding the tax base sufficiently to require the imposition of high rates. These rates, while rarely paid, give Montana the appearance of a high tax state. The council believes the state should broaden the base, restore progressivity to the upper income range of taxpayers, and reduce the rate schedule to reflect what, in fact, taxpayers effectively pay.

Revise the Unitary Method of Corporate Income Taxation

Recommendation: The Governor's Council on Economic Development recommends that legislation be enacted to change the Montana law on the unitary method of taxation to reflect the current Montana Department of Revenue practice of excluding foreign parent corporations from corporate unitary income tax computations.

Rationale: The council's recommendation would leave intact Montana's basic unitary method of tax accounting because it judged that the unitary method insures that out-of-state businesses are treated fairly in comparison to in-state businesses. The council also judged, however, that placing the "foreign parent exclusion" into law would communicate in favorable terms to potential foreign investors the fact that Montana does not utilize the worldwide unitary method.

This recommendation was made in the context of other options for change in the present system of applying the unitary method of corporate income taxation. The other options dealt with the concept of eliminating from tax calculations the economic activities of foreign subsidiaries of domestic corporations, or the so-called waters' edge proposals.

The waters' edge proposals were rejected for several reasons. First, it was recognized that there currently are businesses operating in Montana that are part of an integrated worldwide business, and that the trend is toward more worldwide integration. Excluding all foreign operations from unitary tax calculations would provide an incentive for firms to invest abroad rather than in Montana and the rest of the United States. Also, this change would give many multinational corporations a competitive advantage over Montana corporations and multistate businesses.

Review the Personal Property Tax

Recommendation: The council recommends that the Legislature thoroughly review the Montana personal property tax.

Rationale: The personal property tax has several undesirable features. First, because it falls mainly on business assets rather than net income, the personal property tax is insensitive to short-term variations in ability to pay. It works a particular hardship, therefore, on new businesses facing initial operating losses or on all businesses during recessions in business activity.

Second, the valuation of assets for tax purposes, and the resolution of disputes over valuations, makes the tax expensive to administer and comply with, and creates ill will between the state and the private sector.

Third, the growth of personal property tax in relation to business income means that Montana now has high taxes on personal property in relation to some other states (many of which do not tax personal property at all). To some degree, this diverts business investment and business formation from Montana to other competing states.

Finally, the personal property tax violates the principal of tax neutrality by placing a larger tax burden on businesses that employ above average amounts of taxable assets in relation to net income.

The council recommends that the elimination of the personal property tax be studied further because it recognizes at least two significant obstacles to elimination. The first is that replacement of revenues lost by elimination of the tax would require a very substantial shifting of the burden to other sources. Provided that the burden is not shifted outside the business sector, this means that either the tax on business real property and/or the corporate license tax would have to be increased. The implications of either of these measures would require further study. Second, the shifting of the burden of the personal property tax to any other existing tax narrows the overall tax base and reduces the stability of total state revenue.

Review Montana's Tax Structure

Recommendation: The Governor's Council on Economic Development recommends that the Montana Legislature review the state's tax structure with a view toward property tax reform in the upcoming legislative session.

Rationale: The council believes a balanced tax structure is a key element in Montana's economic development, and that the state's current tax system is unbalanced and heavily reliant on property taxes. Efforts must be taken in the 1987 Legislature to develop a more equitable structure and new sources of revenue should be considered.

In its deliberations, the council considered endorsing Initiative 105, the measure to freeze property taxes. Although the council chose to remain neutral on the issue, it feels that the Legislature must devote attention to Montana's overall tax structure in the upcoming session to ensure that it is fair and balanced.

Reduce Montana's Coal Severance Tax

Recommendation: The Governor's Council on Economic Development urges the governor to recommend to the Legislature that Montana's coal severance tax be reduced to place Montana in a better competitive position with other coal producing states.

Rationale: The council believes that Montana's 30 percent coal severance tax, the highest such tax in the country, is too high and serves as a disincentive to the mining and marketing of the state's coal. While other states in the northern great plains region have increased their coal sales in recent years, Montana has experienced a gradual decline. Coal producers in the state are finding it increasingly difficult to obtain new coal contracts, not only because of the severance tax, but because of the low prices for other energy sources, primarily oil and gas. There is concern among producers that current long-term contracts will not be renewed unless steps are taken to make Montana coal more competitive in the marketplace.

SECTION V

AGRICULTURAL DEBT RECOMMENDATIONS



Re-establish the Linked Deposit Farm Loan Program

Recommendation: The Governor's Council on Economic Development recommends that the linked deposit farm loan program, which was created by the Montana Legislature in the March 1986 Special Session, be continued in a revised form.

Specifically, the council recommends a three point spread, rather than a two point spread, be allowed. Securities pledging requirements should be changed to allow the loan to substitute for current pledging requirements. The term of the loans should be expanded from

six months to a full one-year period. The program itself should be re-established for two years, and the limits of \$50 million for the entire program and \$50,000 per loan should be maintained.

Rationale: The linked deposit farm loan program that recently expired had the potential to make a total of 1,000 loans of \$50,000, for a total of \$50 million. However, the program, through six participating banks, made only 42 loans totaling less than \$1.9 million.

Information from the banks involved in the program and research on similar programs in other states (Il-

linois, Indiana, Minnesota, Kansas, Michigan, Missouri and Ohio) performed by the Agricultural Debt Subcommittee of the Economic Development Council indicates that there were serious problems with the structure of Montana's program.

Specifically, there was insufficient profit motive for banks to meaningfully implement the program. A two point spread was allowed between the CD rate and the loan rate. The banks commented that this was too small. Other states allow a larger spread of 2.5 to five points. The council recommends a three point spread.

The securities pledging requirement of Montana's program was another problem. A minimum of 50 percent pledging of securities was required (and a maximum of 100 percent) over FDIC insurance of \$100,000 of deposits in a given bank. But the agricultural loan itself was secured by either crop insurance or the probability of income from sales. The council recommends changing the pledging requirements laws in Section 17-6-192, MCA, and Section 17-6-103, MCA, to allow the agricultural loan to substitute for existing pledging requirements.

Montana's program had a maximum six months term, which was too rigid for the cash flow requirements of agricultural operations. The council recommends that the term of the loan be flexible, from 30 days to one year.

Further, the duration of the program itself was too short and did not coincide with the operational cycle of farms and ranches in Montana. The council recommends that the agricultural linked deposit program be put in place for two years, and be re-examined at the end of that period.

The expired linked deposit program had an upper limit of \$50,000 available to any one agricultural operation, and a maximum of \$50 million for the entire program. The council recommends that both of these figures be retained.

The cost of the program would be a loss to the state of one interest point for as much as one year on a potential total of \$50 million, or \$500,000.

Allow Emergency State Chartering

Recommendation: The council recommends that the Legislature study the findings of the Montana Commissioner of Financial Institutions relating to emergency state chartering and adopt legislation that would allow immediate chartering of a new state-regulated bank in a failed bank situation.

Rationale: Strong financial systems are critical to maintaining community structures and a viable local business climate. It is important that banking services be maintained in communities because they can help to avoid downward spirals in local economies.

According to Comptroller of the Currency Officer James Timmel, there are an increasing number of bank failures occurring in the United States as a result of the difficult agricultural times and the troubles in the oil and gas industry. Because of the long-term downturn in Montana's agricultural economy, many banks in the state face an uncertain future. Montana needs a system in place that can be used to quickly restructure financial institutions in the event of a failure.

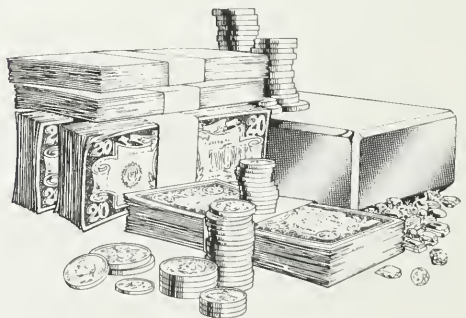
Currently, only federal banks in Montana can engage in emergency chartering. As an example, the failed bank in Columbia Falls was a state bank, but was re-chartered as a national bank for lack of any other option. Bankers perceive advantages to being part of the state regulatory structure, which is more accessible, closer and more responsive than the federal government.

Provide for Emergency Branch Banking

Recommendation: The council recommends that the state enact legislation allowing emergency branch banking in cases where a bank failure represents the loss of a community's only bank. The bank would first be offered for sale as a unit bank. If no bidders emerge, it would then be offered for sale as a branch, but only to existing in-state banks.

Rationale: The council makes this limited branching recommendation because it realizes the importance of local banks to the economies of Montana communities. In communities where farmers and ranchers play a significant role in the local economy, a bank contributes to both the economic and social well-being of the community. Because of the difficult agricultural economy, many banks are facing serious problems.

Implementation of the recommendation would not only help to guarantee that communities will continue to benefit from the services offered by local banks, but also ensure the stability of main street businesses and the community in general, because if people must travel to another community to bank, they are likely to do other business there as well.



Establish an Agricultural Network

Recommendation: The Governor's Council on Economic Development recommends that the governor direct employees from the executive branch of state government to hold agricultural "summit meetings" every two months to inform relevant people, as well as to receive information from them, on national agricultural issues in which the state should have a role.

Rationale: During its deliberations, the Agricultural Debt Subcommittee found that difficulties exist in obtaining information on agricultural issues. Structure is needed to ensure that the state acts in a timely manner on agricultural issues. For example, the attorneys general of other states have quickly become involved in litigation or threat of litigation in certain instances to protect their states' agricultural sector.

Parties involved in Montana's agricultural network should include representatives from the Montana Department of Agriculture and the Montana Department of Commerce, the Legislative Council, the Attorney General, and federal agencies such as the state agricultural statistical agency, Soil Conservation Service, the FmHA, the Small Business Administration, and other USDA agencies.

The state coordination of agricultural issues could also be expanded for involvement in, and obtaining information from, national agricultural organizations.

Address Farm and Ranch Incomes

Recommendation: The council recommends that the Montana Department of Agriculture conduct conferences in various regions of the state showcasing success stories in obtaining off-farm income and in generating income from innovative agricultural sources. People in each region would be chosen to tell how they have succeeded. In conjunction with the conferences, the governor would present an award for outstanding "Innovations in Agriculture."

Rationale: Models for this type of program are in place in other states. One example is Agricultural Resources of Colorado (ARC), in the Colorado Department of Agriculture, which is funded by the U.S. Department of Labor Job Training Partnership Act (JTPA) money, as well as energy conservation rebate money from EXXON. The Colorado program should be closely examined as a possible model to create an Agricultural Resources of Montana (ARM) umbrella organization seeking innovations in agriculture. The ARC draws on existing agricultural agencies such as the Extension Service and appears to operate well on a low budget (\$60,000).

The council believes that maintaining farm and ranch income is an economic development concern and that issues related to maintaining income should be identified and discussed.

Support Agriculture Counseling and Mediation Program

Recommendation: The Governor's Council on Economic Development recommends that the counseling and mediation program that is scheduled to expire on June 30, 1987, be retained and funded at the level included in the Montana Department of Agriculture's 1989 biennium budget request.

Rationale: As of November 1, 1986, this program has received over 400 calls from farmers and ranchers seeking counseling and mediation assistance. These calls have led to the direct involvement by the Department of Agriculture in 22 mediation cases and 21 financial consulting cases. A continuation of the program would produce quantifiable benefits for the agricultural sector.



Establish a Beef Inspection and Grading Program

Recommendation: The Governor's Council on Economic Development recommends that the state establish a beef inspection and grading program to revitalize the Montana beef industry and use Montana packing houses to provide beef for local markets. The program would receive general fund support for initial training purposes only. Continued operations would be self supporting through fees paid by the packers.

Rationale: Most retail beef available in Montana is imported from out of state. This appears to be the result of adoption of federal beef inspection standards in the early 1970s which led to the shutdown of many small packing houses in Montana. Small packers suffered because they did not enjoy the economies of scale that allowed the large packing houses to continue production with increased regulation. Currently, Montana exports live cattle and imports cut beef, but does not add value to beef products sold in the state.

Small packers have the ability to access local markets and compete with out-of-state beef packers who must pay transportation costs to make their product available to Montanans.

Montana should draw upon the experience of other states that have their own inspection programs, and also obtain information that is available from the national organizations such as the Association of State Inspection Programs. A state program that meets federal standards apparently can obtain as much as 50 percent federal funding. A state can also adopt its own standards and operate a completely self-funded program. More information and research is necessary to determine what type of system would be most beneficial to Montana.

State inspection is already in place for eggs, milk and livestock brands through the Montana Department of Livestock. A regulatory structure could be placed in an existing state agency.

A state beef regulatory agency could also provide services for other meat packing, such as elk, in an effort to protect public health and safety, while not impeding commerce in Montana.

Restore and Increase Funding for the Montana Agricultural Experiment Station System

Recommendation: The Governor's Council on Economic Development recommends that the 1987 Legislature restore the original FY87 appropriations level of the Montana Agricultural Experiment Station System. Further, the council urges the Legislature to appropriate \$500,000 per annum for capital improvements for the program.

Rationale: A combination of funding problems in 1986 has resulted in reductions in the Montana Agricultural Experiment Station and Research Center budgets for both personnel and operations, and total elimination of equipment replacement. Total cuts in state general funds amount to \$522,658 for FY87. A restoration of funding to previous levels would result in a total general fund appropriation of \$6,275,232 per year. A higher appropriation would be necessary to counteract federal cuts (\$224,654 annually) and revenue reductions from sales (\$200,000) that occurred because of the depressed agricultural economy.

Cuts in funding for agriculture have cost the state excellent scientists and research staff who have moved to other states for better salaries. Additionally, the inability of the state to upgrade research facilities and equipment have played a role in the loss of talented personnel. Improved laboratories and equipment would provide an incentive to keep and attract some of the best minds in agricultural research.

It is the council's view that now is **not** the time to cut back on agricultural research. Rather, the crisis in Montana agriculture should be confronted by investing in the future. Innovation and experimentation in agriculture are essential to supporting farming and ranching in Montana. Conservative estimates show a 20 percent or more annual return to the state through investment in research centers.

A vital, active, and improving agricultural research program will attract industry contracts and grants to Montana State University. It will also help the university attract out-of-state students.

Agriculture is a vast area of potential technology transfer. It is an industry where applications of scientific research and high technology can bring high returns. Finally, agricultural research can serve to discover new ways to add value to Montana's agricultural commodities.

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